

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of
BIGGIE FURNITURE COMPANY -
FIFTH STREET, JOHN COSTELLO,
TRUSTEE IN BANKRUPTCY .

For Appellant: August B. Rothschild and
Quittner, Stutman & Treister,
Attorneys at Law

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For Respondent: Burl D. Lack, Chief Counsel;
Peter S. Pierson, Assistant Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Biggie Furniture Company - Fifth Street, filed by John Costello, Trustee in Bankruptcy, for refund of franchise tax in the amounts of \$2,110.56 and \$2,195.14 for the income years 1955 and 1956, respectively.

On October 28, 1958, the Franchise Tax Board issued a Notice of Arbitrary Levy of Tax in the amount of \$37.50, pursuant to section 25732 of the Revenue and Taxation Code, against the Biggie Furniture Company - Fifth Street, formerly Andrew Williams Appliance Center, Inc., (hereafter referred to as Biggie) due to its failure to file a return and pay tax for the income year 1957. By letter dated November 25, 1958, Mr. D. Daniel Golden, Certified Public Accountant, informed respondent that Biggie had been included in proceedings "for arrangement" before the United States District Court and that he had been employed as accountant for the receiver. On December 10, 1958, creditors of Biggie filed a petition in bankruptcy against Samuel Rabinowitch, individually and doing business as (among names of other corporations), Biggie Furniture Company - Fifth Street. Adjudication of bankruptcy was made on January 15, 1959. Subsequently, on February 2, 1959, Biggie's corporate powers, rights and privileges were suspended for failure to pay the franchise tax due for 1957, pursuant to section 23301 of the Revenue and Taxation Code.

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Based upon an analysis of Biggie's records, Mr. John Costello, Trustee in Bankruptcy, concluded that the corporation did no business and had no income for the years **1955** and **1956**, and claims for refund of taxes previously paid for those two years were filed with the Franchise Tax Board on April 12, **1960**. Submitted on standard Franchise Tax Board forms, the claims were made in the name of Andrew Williams Appliance Center, Inc., which was the name of the taxpayer on the original returns filed for 1955 and **1956**. The address given for the claimant was "**c/o Daniel Golden, C.P.A., 41 Sutter Street, San Francisco.**" The body of the claims stated in p a r t :

This corporation is owned by Samuel Rabinowitch.... Mr. Rabinowitch is now in bankruptcy. Proceeds of this claim will be used in partial satisfaction of creditors' claims.

The claims were signed by Samuel Rabinowitch and respondent treated them as having been filed by Biggie.

On May **4, 1960**, respondent advised Biggie that the claims for refund were unacceptable because the corporation was under suspension and had not been revived. Later that month, Mr. Golden requested information concerning 'the **sus-**pension and tax liabilities of Biggie, stating that the corporation was in bankruptcy and the trustee would like to consider satisfying the liabilities necessary to validate the refund claims.

On the basis of information supplied by the Franchise Tax Board, the trustee paid the arbitrary assessment for **1957** in the amount of \$37.50 on August 29, **1960**. The corporation was not relieved from its suspension, however, because the payment was not accompanied by a written application for **revivor**, as required by section 23305 of the Revenue and Taxation Code; To this date, Biggie remains suspended.

In reply to an inquiry from Mr. Golden concerning the disposition of this matter, respondent, in January **1962**, denied the claims for refund on the ground that Biggie had never been properly revived and since the statute of limitations for the years **1955** and **1956** had expired, subsequent reinstatement of the corporation could not validate the claims. In a letter dated February 5, **1962**, Mr. Golden stated that the claims had been made on behalf of John Costello, the trustee in bankruptcy for Biggie, and that he, Golden, had prepared them as **Costello's** representative. The Franchise Tax Board declined to change its position and, **in** due course, Mr. Costello filed **this** appeal.

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The Franchise Tax Board contends that because **Biggie's** corporate rights and powers are suspended, this appeal cannot be maintained. It concedes that it has no defense on the merits **in the event** we decide that the appeal may 'be pursued.

We have previously held that a suspended corporation may not appeal to this board. (Appeal of Lomita Plaza, Inc., Cal. St. Bd. of Equal., March 7, 1961.) In this case, however, the appeal was not filed by Biggie, the suspended corporation, but by John Costello, Trustee in Bankruptcy. Furthermore, the Franchise Tax Board was fully advised that they were dealing with the trustee in bankruptcy, or his **representatives**, and we are of the opinion that the refund claims must be considered to have been filed by Mr. Costello.

Under section 70 of the Bankruptcy Act (11 U.S.C.A. § 110) title of the bankrupt to certain property vests by operation of law in the trustee as of the date of the filing of the petition in bankruptcy. A bankrupt's right to a refund of taxes is property included under this **provision**. (Chandler v. Nathans, 6 F.2d 725, 728.) Thus neither Biggie nor Mr. Rabinowitch had any right, title, **or** interest in the claims at the time they were filed, as a matter of law.

The issue is therefore reduced to whether or not the lawful suspension of Biggie's corporate powers prevented the trustee in bankruptcy from prosecuting these refund claims.

A trustee succeeds to the bankrupt's title to **choses** in action subject to any defense or counterclaim which would have been available against the bankrupt; thus the rights of the trustee are no greater than the rights of the bankrupt. (In re Woodworth, 85 F.2d 50; Lynch v. Rogan, 50 F. Supp. 356.) It is to be noted, however, that the alleged bar in the instant appeal arises not from a defect in the claims themselves but solely from the incapacity of the corporation to present those claims. While Cleveland v. Gore Bros., 14 Cal. App. 2d 681 [58 P.2d 931], held that an individual who was the assignee of a suspended corporation's cause of action was subject to the same incapacities with respect to a suit on the claim as was the assignor corporation, we believe this decision is not applicable to a trustee in bankruptcy.

The power of Congress in matters relating to bankruptcy is paramount. (Taubel-Scott-Kitzmiller Co. v. Fox, 264 U.S. 426, 430 [68 L. Ed. 770].) A California statute providing for the suspension of domestic corporations for nonpayment of taxes cannot interfere with the bankruptcy laws by preventing a suspended corporation from filing a voluntary petition in bankruptcy. (In re Pacific Alloy & Steel Co., 299 F. 952, cert. denied, 266 U.S. 618 [69 L. Ed. 471].) See

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also California Iron Yards Co. v. Commissioner, 47 F.2d 514, holding that the suspension of a California corporation could not vitiate the effectiveness of waivers of the statute of limitations executed by the corporation for the federal tax authorities during the period of its suspension.) Furthermore, it has been said that once the trustee in bankruptcy acquires title to the bankrupt's assets by operation of law, the **continued existence** of the bankrupt as a corporation is non-essential to the bankruptcy process. (In re International Match Corp., 79 F.2d 203, 204, cert. denied, 296 U.S. 652 [80 L. Ed. 464].)

While Congress has made federal bankruptcy trustees subject to state and local taxes and the enforcement thereof in certain cases (28 U.S.C.A. § 960, formerly § 124a; Boteler v. Ingels, 308 U.S. 57 [84 L. Ed. 78]; California v. Gillis, 69 F.2d 746, aff'd, 293 U.S. 62 [79 L. Ed. 199]), this specific grant of authority has been narrowly limited to taxes arising from the conduct of the bankrupt's business under authority of the court. (In re West Coast Cabinet Works, 92 F. Supp. 636, aff'd sub nom. California State Board of Equalization v. Goggin, 191 F.2d 726, cert. denied, 342 U.S. 909 [96 L. Ed. 680]; State Board of Equalization v. Boteler, 131 F.2d 386; In re California Pea Products, Inc., 37 F. Supp. 658.)

The facts of the instant appeal are distinguishable in that the suspension of Biggie's corporate powers did not arise from the failure of the trustee to pay taxes which resulted from the continued operation of the corporation's business during the post-bankruptcy period. Indeed, it appears that the trustee did not continue the **bankrupt's** business. The suspension resulted from the bankrupt's failure to pay taxes which came due prior to the filing of the petition **in bankruptcy**. For this reason, we view Biggie's suspension as being closely analogous to the **pre-bankruptcy penalties** that are barred by section 57, subdivision (j) of the Bankruptcy Act (11 U.S.C.A. § 93, subd. (j)), which provides:

Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the **act**, transaction, or **proceeding out** of which the penalty or forfeiture **arose**, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

In holding that section 57, subdivision (j) bars the **recovery of** federal penalties even though they were included in liens that had been perfected against the **bankrupt's** estate,

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the Court, in Simonson v. Granquist, 369 U.S. 38 [7 L. Ed. 2d 557], noted that penalties were in a category not favored in bankruptcy. It explained that tax penalties were generally imposed as punitive measures against persons who were at fault and that enforcement of such penalties against the bankrupt's estate punishes not the delinquent taxpayer, but the entirely innocent creditor, (See also In re Burch, 89 F. Supp. 249.) While section 57, subdivision (j) refers to "Debts owing ... as a penalty" and cannot strictly be applied to the **suspension** of a corporation, which is another form of penalty, we cannot ignore the fact that the position urged upon us by the respondent reaches a result that is tantamount to imposing a penalty on the bankrupt's estate equal in amount to the refund claims. A denial of appellant's claims for refund, claims that are undisputedly valid on their merits, will punish the **creditors** for Biggie's delinquency as effectively as if a penalty were allowed.

Turning now to our own Revenue and Taxation Code, we find that it contains provisions designed to make a suspension under section 23301 effective. Section 23304 declares that a contract made in violation of section 23301 is voidable at the instance of any party other than the taxpayer. And section 25962.1 provides that any person who attempts to exercise the powers, rights and privileges of a suspended corporation is punishable by fine or imprisonment or both. If we apply the holding of Cleveland v. Gore Bros., supra, 14 Cal. App. 2d 681 [58 P.2d 931] to trustees in bankruptcy it would necessarily follow that they would be subject to sections 23304 and 25962.1 as well as section 23301. Thus, if the corporation in bankruptcy were suspended by the state, any contract entered into by the trustee in the normal performance of his duties would be voidable and the trustee would be subject to fine or imprisonment. Such state interference with the process of the bankruptcy court would **constitute** a clear intrusion on the supreme power to regulate **bankruptcy matters** vested in Congress by the Constitution and, in the absence of express authority granted by Congress, would be invalid. We are of the opinion that section 23301 of the Revenue and Taxation Code was not intended to be and cannot be applied here to bar appellant from **exercising** whatever rights he may otherwise have to claim the instant tax refund.

O R D E R

Pursuant to the views expressed in the opinion of the board on **file in this** proceeding, and **good cause** appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant, to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Biggie Furniture Company - Fifth Street, filed by John Costello, Trustee in Bankruptcy, for refund of franchise tax in the amounts of \$2,110.56 and \$2,195.14 for the income years 1955 and 1956, respectively, be and the same is hereby reversed.

Done at Sacramento California, this 12th day
of May, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman
John W. Lynch, Member
Frederick W. Hain, Member
Walter K. Kiley, Member
_____, Member

Attest: J. J. Freeman, Secretary